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Begbies Traynor

Businesses warned of dangers of overtrading

Falling unemployment and rising house prices are the latest economic indicators to support George Osborne's assertion that Britain is 'turning the corner' and recovering from the past five years of recession and stagnation.

But while the Chancellor believes the economy is reaching 'escape velocity' from the longest downturn on record, businesses are being warned to tread carefully when aggressively chasing new work as business confidence picks up.

According to Julian Pitts, regional managing partner of corporate recovery specialists Begbies Traynor in Yorkshire and the North East, economic recoveries have traditionally seen many SME businesses in particular overstretch themselves financially and run out of working capital.

He said: "Overtrading is fundamentally when a business runs out of cash. This is most evident in manufacturing companies when businesses have to commit to the raw material to make the products that are in demand due to rising sales.

"Unfortunately this typically results in a negative cash flow situation as payment for the finished goods will be in three or four months' time, but the payment to the supplier is often on 60 day terms or sometimes payment up front."

But even away from manufacturing, any business can succumb if the gap between funding new work and being paid for invoices that have already been issued grows too large.

“While it may be cause for celebration – the longed-for rise in orders can have tragic consequences and catch out even the most experienced director.

“Traditionally, each time the economy recovers from a recession or downturn, a large number of businesses fall victim to overtrading and end up failing in what should be good times, despite having survived years of bad.”

Mr Pitts said: “This recovery was always meant to be about the so-called march of the makers and the fact that last week’s manufacturing figures showed orders and output growing at their fastest rate for 20 years, suggest that this might finally be the case.

“But while good news for the economy, they do point to a particularly high risk of overtrading, and businesses need to take heed if they are to survive the good times as well as the bad.

“That need not mean turning down orders – though it could. Businesses might also want to consider using invoice discounting or factoring as a means of managing cash flow between invoices being issued and paid. It also pays dividends to have a good relationship with your bank and keep them advised of your growing sales book and the fact that it may have a temporary negative effect on your cash flow.

“If in doubt, it is always better to speak to your professional advisers sooner rather than later.”

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Photo shows: Julian Pitts, regional managing partner of corporate recovery specialists Begbies Traynor in Yorkshire and the North East

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